



**CITY OF LODI  
COUNCIL COMMUNICATION**

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**AGENDA TITLE:** Adopt a resolution authorizing the City Manager to extend the consulting services agreement with McDonald Partners, Inc. through June 2004 to provide bulk power cost modeling and strategic services to the Electric Utility Department (\$70,000) (EUD)

**MEETING DATE:** January 7, 2004

**PREPARED BY:** Electric Utility Director

**RECOMMENDED ACTION:** That the City Council adopt a resolution authorizing the City Manager to extend the consulting services agreement with McDonald Partners, Inc. through June 2004, to provide bulk power cost modeling and strategic services to the Electric Utility Department (\$70,000)

**BACKGROUND INFORMATION:** The City of Lodi Electric Utility Department (EUD) has relied on the Northern California Power Agency (NCPA) to handle most of its seasonal energy needs. In the past, energy prices were based on production costs. Now, energy prices are market driven. Markets have not been as volatile as 2001, but recent price volatility shows that we are beyond the low prices following the 2001 crisis. Market risk is still viable. It is the intent of the EUD to reduce our exposure to market prices and lock in a stable and competitive energy rate for our customers.

NCPA uses a sophisticated production cost model to optimize the value of NCPA resources for the ten NCPA pool members. Lodi is a member of the NCPA pool and has traditionally benefited from the cost modeling provided to all members. NCPA must continue to focus on the entire NCPA pool. It is the EUD's intent to drastically limit our exposure to the vagaries of the existing energy market place. In that regard, we have previously retained the technical expertise of McDonald Partners, Inc. developing a financially based production cost model. The arrangement, which we are asking the Lodi City Council to approve, provides for a number of tasks to be performed by McDonald Partners.

- Maintain Lodi Electric's Resource Planning Model.
- Analyze and provide recommendations related to power market strategies to reduce market risk.
- Assist in negotiating agreements and evaluating the credit risk of energy suppliers.
- Meet in Lodi on a monthly basis to review strategies.

The contract amount will cover work through June 2004.

**FUNDING:** 160603.7323

**Funding Approval:**   
Vicky McAthie, Finance Director

**APPROVED:**   
H. Dixon Flynn, City Manager

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January 7, 2004  
Page 2



Alan N. Vallow  
Electric Utility Director

**PREPARED BY:** Boris Prokop, Power and Rates Manager

ANV/BP/lst

Attachments

cc: City Attorney

CITY COUNCIL

LARRY D. HANSEN, Mayor  
JOHN BECKMAN  
Mayor Pro Tempore  
SUSAN HITCHCOCK  
EMILY HOWARD  
KEITH LAND

# CITY OF LODI

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H. DIXON FLYNN  
City Manager  
SUSAN J. BLACKSTON  
City Clerk  
RANDALL A. HAYS  
City Attorney

December 2, 2003

McDonald Partners, Inc.  
222 High Eagle Road  
Alamo, CA 94507

Dear Sandra and Michael:

Lodi Electric proposes to continue the consulting services arrangement with McDonald Partners, Inc. (McDonald Partners) for the remainder of the 2003/2004 fiscal year in which McDonald Partners works with Lodi Electric staff to develop and execute strategies that are consistent with a goal of maintaining long-term price stability for Lodi Electric's customers. During this period, McDonald Partners will continue to work under the direction of the City of Lodi Electric Utility Director and will be responsible for developing and assisting in the implementation of comprehensive energy commodity management strategies including, but not limited to the following specific activities:

- Maintain Lodi Electric's Integrated Resource Planning Model to include current load forecasts, gas and power price forecasts, resource utilization, price risk exposure and budgetary impacts.
- Compare actual data to forecasts to monitor the accuracy of the Integrated Resource Model.
- Make available McDonald Partners' proprietary forward gas and power curve data on a quarterly basis throughout the engagement.
- Negotiate enabling agreements with credit-worthy gas, power, and financial products suppliers.
- Perform and maintain counter party credit analyses.
- Monitor Lodi Electric's mark-to-market exposure/liability on term contracts.
- Identify opportunities and recommend transactions for utilization of Lodi Electric physical assets including Lodi's share of the COTP and the Lodi Gas Storage Project.
- Recommend appropriateness of physical and financial hedging strategies for natural gas, power, and debt management.
- Monitor gas and power markets on a regular basis and identify potential transaction structures.
- Develop term sheets, solicit bids/offers from a pool of providers and analyze provider proposals.
- Provide transaction follow up to ensure proper deal confirmation, scheduling, accounting, and billing.
- Meet in Lodi on a monthly basis to review strategies.

Proposed fee: \$11,500 per month for the remainder of fiscal year 2003/2004. Should additional meetings be required, incremental meeting time will be billed at \$150/hour. Either party may cancel at any time on thirty days written notice.

All information related to this assignment will be held in strictest confidence. No work shall be performed by anyone other than Sandra or Michael McDonald without the express written approval of Lodi Electric.

In addition to the fees proposed above, all out-of-pocket expenses (which shall include, but not be limited to, travel, lodging, telephone, overnight mail, postage and copying) shall be for the account of Lodi Electric. Fees and out-of-pocket expenses will be billed monthly.

If the terms of this engagement as set forth in this letter are satisfactory, kindly sign the acceptance and return an original to me at the above address. If you have any questions or need additional information, please call me at (209)-333-6762. I look forward to working with you on this assignment.

**MCDONALD PARTNERS, INC.**

**CITY OF LODI**

\_\_\_\_\_  
Sandra McDonald, Principal

\_\_\_\_\_  
H. Dixon Flynn, City Manager

**APPROVED AS TO FORM**

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Randall A. Hays, City Attorney

**ATTEST**

\_\_\_\_\_  
Susan Blackston, City Clerk

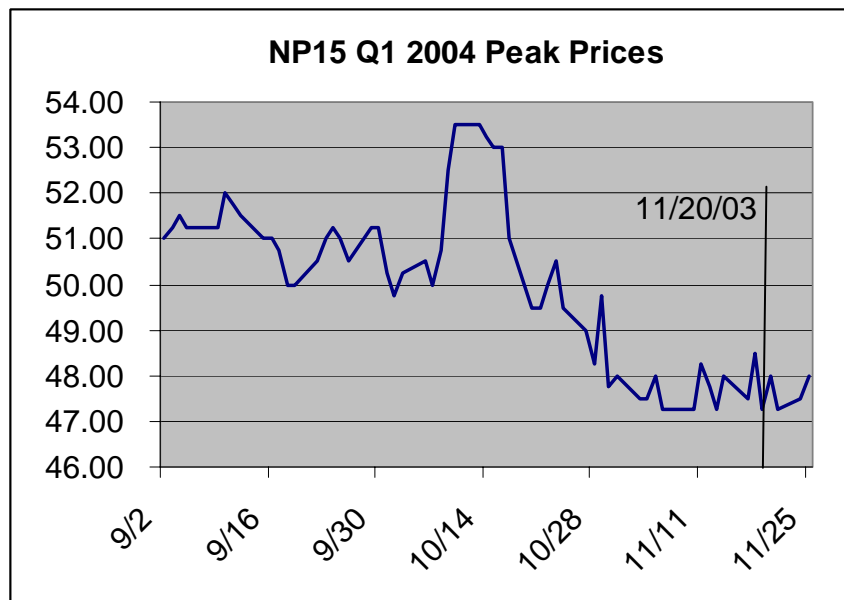
**McDonald Partners Activity Report**  
**City of Lodi**  
**July 1, 2003 through December 31, 2003**

1. **Third Quarter Resource Deficiency:** In the summer of 2003, McDonald Partners, projected that Lodi would require 15 MW of additional energy during off peak hours for the months of July, August, and September and an additional 10 MW of energy during on peak hours in August. In mid-June, McDonald Partners recommended that Lodi solicit bids for energy from power suppliers to satisfy these requirements. McDonald Partners managed the solicitation process which resulted in purchases of the required off peak energy at a price of \$43.75/MWh and on peak energy at a price of \$61.75/MWh. These purchases allowed Lodi to take advantage of attractively priced off peak energy and to avoid exposure to on peak energy price volatility during August when prices in prior years have exceeded \$100/MWh.
2. **Seattle Exchange:** In March 2003, NCPA staff recommended an arrangement for the return of winter 03-04 energy to Seattle whereby the Participants would return a fixed amount of on-peak energy at NP 15 instead of the actual amount of energy the contract required to be delivered at COB. To compensate for incremental volumes at NP15 and the price differential between COB and NP15, the Participants were offered a payment of \$100,000. McDonald Partners recommended that Lodi not take part in this arrangement since (i) Lodi's short position permits Lodi to purchase energy to deliver at COB without utilizing the COTP or paying ISO exit charges, and (ii) the \$100,000 offered to the Seattle Exchange participants was substantially less than the transaction was worth from Lodi's perspective. The transaction was ultimately executed on behalf of other NCPA participants, which left Lodi with the actual return obligation at COB during December 2003 and the first quarter of 2004.

In early October, Lodi was offered an opportunity to "cash out" its SCL delivery obligation for a price of \$49.75/MWh for all contract hours. To maximize Lodi's negotiating leverage, McDonald Partners located the only seller able to provide energy in a south to north direction at COB and used this leverage to negotiate a cash-out price of \$47.60/MWh. The \$2.15/MWh lower price represents a savings to Lodi of \$78,000.

Had Lodi executed the spring transaction as proposed by NCPA, Lodi Electric would have received approximately \$17,000 for the spread between COB and NP15 on the return quantities. By waiting and negotiating its own transaction, Lodi realized an incremental \$30,000 (\$47,000 total) relative to participating in the spring transaction and locking in its NP15 delivery obligation on the same day the cash-out transaction occurred.

3. **December and 1<sup>st</sup> Quarter Resource Deficiency:** Lodi Electric is expected to require approximately 40,000 MWh of purchased energy during the month of December and the first quarter of 2004. McDonald Partners monitored market prices for these periods throughout the fall and recommended that Lodi solicit bids for energy in mid-November. As the graph below illustrates, Lodi Electric executed its winter transactions at near market lows. Lodi Electric benefited by approximately \$40,000 for each dollar saved from waiting. Had Lodi locked in when prices spiked in Mid-October, the utility's purchased power bill would have been nearly \$200,000 higher.



In addition to monitoring overall market prices for this period, McDonald Partners also monitored the price spread between COB and NP 15 to determine whether it was cost effective to purchase Lodi's energy needs at COB rather than NP15. Since price spreads between these two delivery points seemed attractive, McDonald Partners conducted a bid process in which five firms were asked to price a variety of products at both delivery points. In a series of eleven transactions, Lodi purchased for its own load

and maximized its COTP entitlement during those hours when the COB/NP 15 price differential made purchasing at COB advantageous. The transactions resulted in a net purchase price of \$39.40/MWh (including the benefit of excess sales) and a savings of \$140,000 relative to simply purchasing Lodi's energy requirements at NP15.

4. **Digester Project:** Lodi was recently approached by a company in the business of installing anaerobic digesters and electric generators to convert agricultural waste to electrical energy. McDonald Partners is providing the City with independent economic analysis of this opportunity.
5. **NCPA Proposals:** McDonald Partners continues to analyze various proposals brought forward by NCPA staff or other member participants regarding operation or price risk management of NCPA resources. Currently, McDonald Partners is analyzing a proposal from the City of Alameda regarding the STIG plant located adjacent to the White Slough Water Treatment Facility.
6. **Enabling Agreements:** In order to ensure the best possible price for power purchases and sales, McDonald Partners has increased the number of suppliers with whom the City has transaction enabling agreements and credit approvals in place from one to five.
7. **Lodi Gas Storage Project:** Lodi was granted storage capacity in the Lodi Gas Storage Project for a ten-year period as a result of support the City provided during the licensing process for that project. McDonald Partners has assisted the City in analyzing the City's options for use of that capacity and is working with Lodi's attorneys to resolve legal issues with the capacity contract. Once the contract is signed, McDonald Partners will assist the city in optimizing the value of this asset.

RESOLUTION NO. 2004-07

A RESOLUTION OF THE LODI CITY COUNCIL AUTHORIZING  
THE CITY MANAGER TO EXTEND THE CONSULTING  
SERVICES AGREEMENT WITH MCDONALD PARTNERS, INC.,  
TO PROVIDE BULK POWER COST MODELING AND  
STRATEGIC SERVICES TO THE ELECTRIC UTILITY  
DEPARTMENT

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NOW, THEREFORE, BE IT RESOLVED that the Lodi City Council does hereby authorize the City Manager to extend the consulting services agreement with McDonald Partners, Inc., to provide bulk power cost modeling and strategic services to the Electric Utility Department, in an amount not to exceed \$70,000.00 through June 30, 2004.

Dated: January 7, 2004

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I hereby certify that Resolution No. 2004-07 was passed and adopted by the Lodi City Council in a regular meeting held January 7, 2004, by the following vote:

AYES: COUNCIL MEMBERS – Beckman, Hitchcock, Howard, Land, and Mayor Hansen

NOES: COUNCIL MEMBERS – None

ABSENT: COUNCIL MEMBERS – None

ABSTAIN: COUNCIL MEMBERS – None



SUSAN J. BLACKSTON  
City Clerk